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UNFPA INTERNAL AUDIT AND OVERSIGHT ACTIVITIES IN 2005

Report of the Executive Director

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I. INTRODUCTION

1. Pursuant to decisions 2004/17 and 2004/39 on a framework for resolution of issues contained in internal audit reports, and to a request made by the Executive Board at its second regular session in 1996, the Executive Director is pleased to present to the Board a summary of the internal audit and oversight activities of UNFPA in 2005.

2. During its annual session in 2005, the Executive Board urged UNFPA to base its oversight and accountability activities on a corporate risk model and develop risk-assessment functions in its audit offices. In decision 2005/19, the Board also encouraged UNFPA to strengthen analysis of the outcomes of audits; nationally executed projects; and the follow-up actions taken by project management to address audit observations and recommendations.

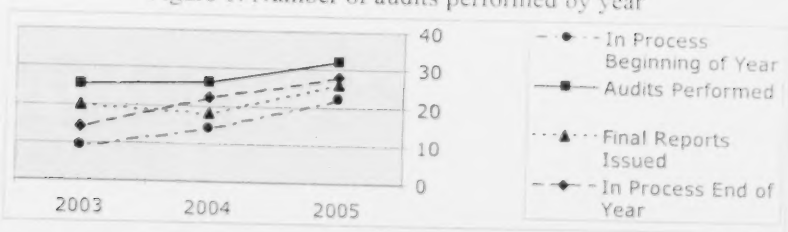
3. In compliance with the request by the Executive Board, the present report on internal audit and oversight activities presents a new structure to allow a prospective analysis of the risk universe of UNFPA. This report delineates a transition from the traditional enumeration of audit findings to the mapping of risks and the analysis of trends. The purpose of the new format is to provide the Executive Board with a tool that facilitates the identification of risks and actions taken by the organization to minimize them, and the follow-up of recommendations. This transition offers two challenges: being the first of a series of prospective analyses, the present report may not cover complete time series since many variables were not measured in the past; secondly, the report is based on risk management, a method which, recently introduced in UNFPA, will require a learning process and a cultural adaptation throughout the organization.

II. INTERNAL AUDIT AND REVIEW ACTIVITIES

A. Activities in 2005

4. Since 2003, UNFPA has steadily increased the number of audits performed and audit reports issued (see figure 1). In 2005, the UNFPA Division for Oversight Services (DOS) carried out 32 internal audits.

Figure 1: Number of audits performed by year



5. In 2005, pursuant to Executive Board decision 2005/19, DOS performed two audits at headquarters. One audit reviewed the migration from the previous financial system named Integrated Management Information System (IMIS) to the new system called Atlas. The other audit reviewed the Fund's Humanitarian Response Unit.

6. The internal audit and review activities carried out during 2005 included the following:

(a) Management audits of 17 offices (12 in the Africa region, one in the Latin America and Caribbean region, two in the Arab States and Europe region, and two in the Asia and the Pacific region);

(b) Review of a sample of 211 audit reports covering 2004 activities for projects executed by Governments and non-governmental organizations (NGOs) carried out by the UNFPA Audit Services Branch with the assistance of a consultant;

(c) Contracted audits in six country offices in the Asia and the Pacific region and seven country offices in the Arab States, Europe and Central Asia region.

7. In 2005, 1,380 recommendations were issued. Table 1 below shows the distribution of audit recommendations by risk category and level of impact (high, medium or low).

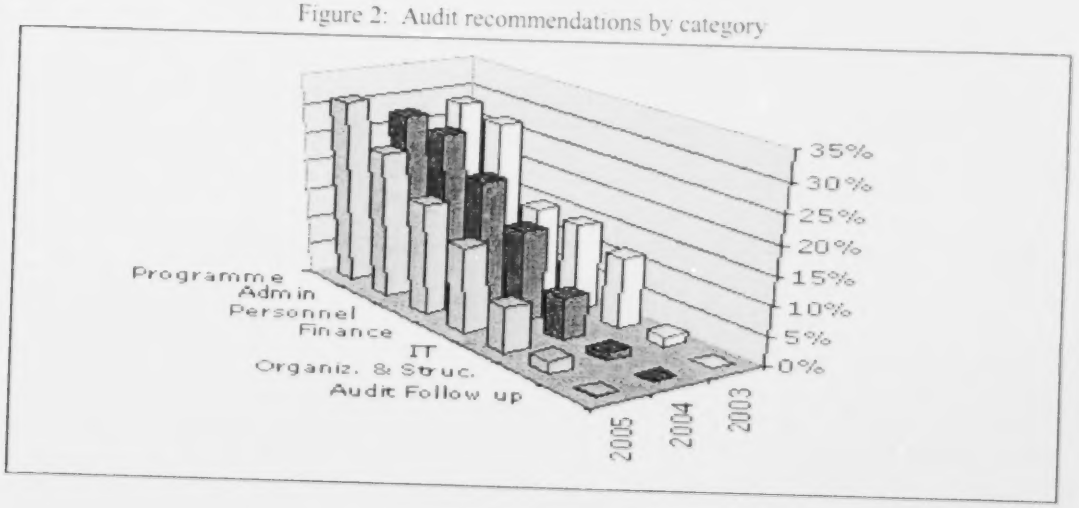
Table 1: Risk level of recommendations

Risk category	High	Medium	Low	Total
Process	463	556	63	1,082 (78%)
Technology & Systems	41	68	0	109 (8%)
People	49	52	4	105 (8%)
Relationship	23	27	1	51 (4%)
External	12	20	1	33 (2%)
Total	588 (43%)	723 (52%)	69 (5%)	1,380 (100%)

B. Country office audits

8. The trend in the audit recommendations issued in 2003, 2004 and 2005 as well as the breakdown by category are depicted in figure 2.

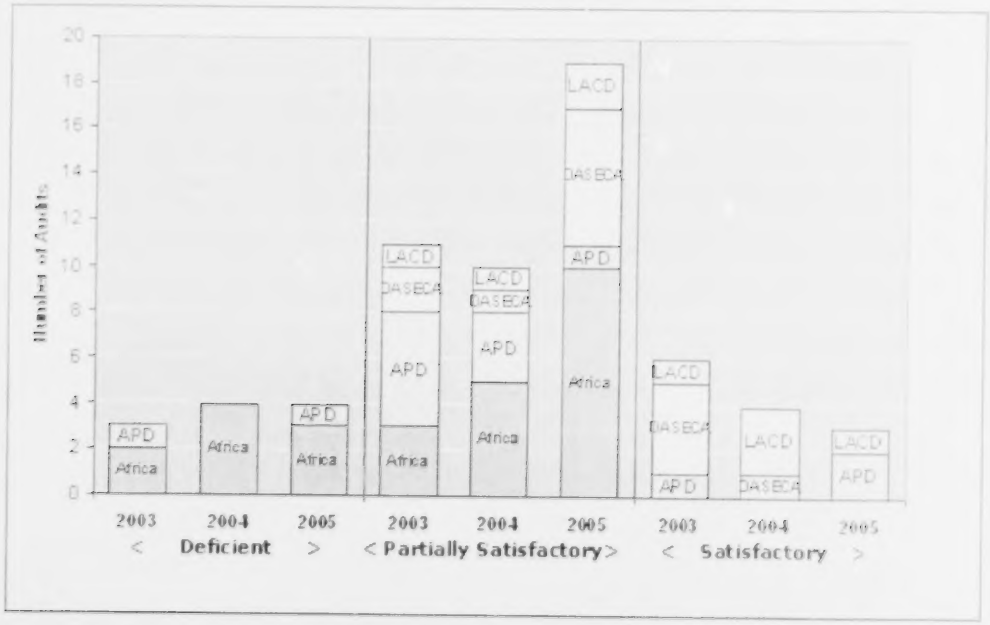
Figure 2: Audit recommendations by category



9. Figure 2 shows that there has been no significant change in the distribution of audit recommendations by category over the past three years.

10. Of the 26 reports issued in 2005, the level of internal controls and the compliance with financial, administrative and programme requirements were found to be satisfactory in three offices, partially satisfactory in 19 offices and deficient in four offices. Figure 3 gives the breakdown of audit ratings by region and by year. It shows that two regions are exposed to higher risks. This higher vulnerability is mostly due to programme execution by partners and cash transfer modalities. This recurring issue is a matter of concern as it induces financial risks and contributes also to low ratings of internal audits of country offices. In some cases, management should consider the opportunity cost of implementing programmes through direct execution and payment while cooperating with other United Nations entities to enhance local management capacity. The following section on national execution (NEX) offers some perspective for consideration.

Figure 3: Breakdown of audit ratings by geographical divisions[1]



C. Nationally executed project audits

11. In 2005, UNFPA received NEX audit project reports for expenditure amounting to $86,875,334, representing 77 per cent of the total expenditure incurred on projects executed by Governments and NGOs. DOS reviewed the audit reports only for the year ended 31 December 2004, as the reports for the year ended 31 December 2005 are submitted commencing in March 2006. A key challenge is that the

[1] APD = Asia and the Pacific Division; AD = Africa Division; DASECA = Division for Arab States, Europe and Central Asia; LACD = Latin America and Caribbean Division.

reliability of current national execution processes is not improving over time. In 2004, 32.7 per cent of all NEX reports received were qualified, as opposed to 29.6 per cent for 2003. There are two categories of risks in NEX, one related to external risks and the other related to the audit process of NEX, both being interrelated: the former is a function of the quality of the governance of implementing partners, a parameter over which the United Nations system has little leverage; the latter relates to the ability and the possibility of UNFPA country offices to commission quality NEX audits.

12. Figure 4 gives an overview of the quality of NEX audits. UNFPA country teams do not always have the capacity to manage the NEX audit process or cannot rely on the quality of audits outsourced locally. Of the 211 audit reports for 2004 that were reviewed and evaluated, covering 44 countries, there were marginal improvements in comparison to 2003 (see figure 5) as regards the adequacy of the audit plan and scope; and the adequacy of the country office's assessment of the resultant reports, and of the action plan.

13. The impact of the risk related to NEX is not to be neglected. It is estimated that approximately 4 per cent of the total amount of NEX expenditure cannot be accounted for. The main causes identified by the NEX auditors relate to problems in national execution, such as over-expenditure, or insufficient documentation, absence of reconciliation of accounts, under- or over-statement of charges, or incorrect chart of account. This is why the organization is planning to enhance risk management and review the efficacy of the new cash transfer modalities adopted by the United Nations Development Group (UNDG) Executive Committee agencies.

Figure 4: 2004 NEX evaluations

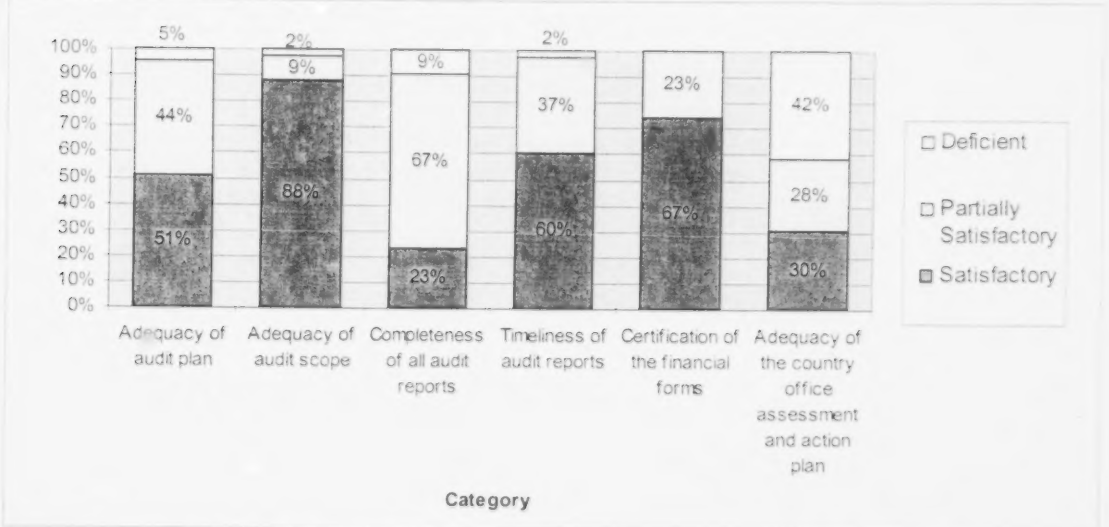
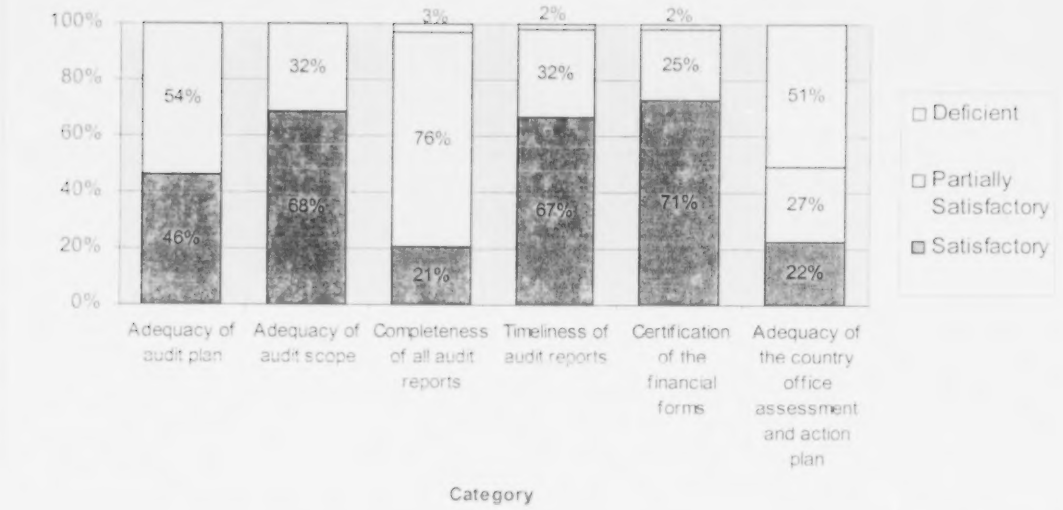


Figure 5: 2003 NEX evaluations



D. Private sector pro bono offer

14. In March 2005, the United Nations, including its funds, programmes and specialized agencies, signed an agreement with PricewaterhouseCoopers accepting a pro bono offer of 8,000 hours of professional services. The services were offered to assist with efforts to enhance accountability and transparency of the use of the contributions made under the Tsunami Flash Appeal. This agreement is the first major pro bono agreement between the United Nations and the private sector with the express goal of improving transparency and accountability.

15. UNFPA was allocated 1,000 hours of professional services, and engaged PricewaterhouseCoopers to provide two services: risk management; and forensic data analysis.

Risk management

16. This exercise involved assessing UNFPA financial, reputational and operational vulnerabilities and taking the steps necessary to mitigate them. UNFPA has completed the first step, which involved compiling a matrix highlighting the organization's key risks. Senior UNFPA staff members from all departments were involved in this process.

17. UNFPA is about to begin the second step which involves testing the controls which exist to mitigate identified risks; determining the adequacy of the controls; and making recommendations for further strengthening them.

Forensic data analysis

18. PricewaterhouseCoopers is using their proprietary software to analyse UNFPA Atlas data (in tsunami-affected countries) with the aim of identifying potential fraud, anomalies and other irregularities. UNFPA is conducting this process in conjunction with UNDP in order to save man-hours and also because the Atlas system is shared with that agency. Given the volume of information and the time spent by PricewaterhouseCoopers in understanding UNFPA systems, the first phase of this process was only recently completed.

E. Inter-agency cooperation and harmonization

19. UNFPA participated in the working groups dealing with oversight mechanisms related to harmonized cash transfer modalities, multi-donor trust funds, and cooperation and financing with international organizations like the European Union and the World Bank. As requested by the Executive Board, UNDP, UNFPA, UNICEF and WFP continue to examine common ways to standardize audit ratings based on risk management.

F. Oversight committee

20. The Executive Director decided to further strengthen oversight procedures of UNFPA by appointing an oversight committee of five independent members with a charter consistent with industry standards and the guidance provided by the Secretary-General. The Oversight Committee will advise the Executive Director on:

(a) The strategic processes for risk control and governance, and the internal control framework, including information technology security and control;

(b) The accounting policies, the financial statements, and the annual report of the organization, including the process for review of the financial statements prior to submission to the United Nations Board of Auditors, levels of error identified, and management's letter of representation to the United Nations Board of Auditors;

(c) The planned activities and results of both internal and external oversight entities;

(d) Any significant deficiencies in the design or operation of internal controls or material weaknesses therein and any fraud involving management or other employees;

(e) Adequacy of management response to issues identified by audit activity, including the observations and recommendations by the United Nations Board of Auditors;

(f) Assurances relating to the corporate governance requirements for the organization;

(g) Proposals for tendering for purchase of either internal audit or non-audit services from contractors who provide audit services.

21. To that effect the Oversight Committee is empowered to:

(a) Make recommendations in case of disagreements between management and oversight bodies;

(b) Pre-approve all auditing services;

(c) With the approval of the Executive Director, to retain outside counsel or persons having special competence as necessary;

(d) Seek any information it requires from employees – all of whom are directed to cooperate with the Committee's requests – or external parties;

(e) To ask any official of the organization to assist the Committee with its discussions on any particular matter;

(f) Meet with UNFPA officers, United Nations Board of Auditors or outside counsel, as necessary.

22. The modus operandi of the Oversight Committee will be re-examined after the completion of the comprehensive review of governance arrangements within the United Nations and its funds, programmes and specialized agencies.

G. Fraud monitoring and control activities

23. UNFPA undertook a number of initiatives in 2005 with regard to fraud monitoring and control activities. These include the following:

(a) A policy was created informing staff of the organization's zero tolerance towards fraud and other serious unethical behaviour. In addition, a circular on fraud was launched by senior management describing the accountabilities and responsibilities of all staff members;

(b) An online whistle-blower hotline was established on the UNFPA web site at www.unfpa.org. This service allows both staff and the general public to anonymously report any offences involving UNFPA for further investigation;

(c) Discussions were held with international private sector accounting firms on implementing a cost-effective anti-fraud programme and controls methodology within UNFPA, which is consistent with the Committee of Sponsoring Organizations of the Treadway Commission better practice. A request for a proposal will be issued to these firms by mid-2006.

H. Staffing

24. DOS comprises two Branches: (a) the Oversight and Evaluation Branch; and (b) the Audit Services Branch. The staffing status is presented in table 2 below. Authorized posts in the Oversight and Evaluation Branch include one Chief, four Evaluation Advisers and two support staff; and in the Audit Services Branch, one Chief, five Audit Specialists at headquarters and two based in Africa, as well as two support staff.

Table 2: Staffing as at 31 December 2005

Functional title	Authorized	Encumbered	Vacant
Director and Managers	3	2	1
HQ Audit Specialists	5	4	1
Outposted Audit Specialists	2	2	0
Evaluation Advisers	4	3	1
Support staff	5	5	0
Total	19	16	3

25. Two audit specialists joined DOS during the first quarter of 2005 while another one left in the third quarter. The recruitment for the posts of Chief, Oversight and Evaluation Branch/Deputy Director and Evaluation Adviser is in process and should be completed by the fourth quarter of 2006. To be more effective the division would require one additional auditor and one investigator.

I. Developing capacity in risk management

26. As part of continuous staff development, the Audit Services Branch staff received training on audit software to improve the efficiency of the audit process as well as on enterprise risk management. In addition, the staff attended a two-day training on the basics of fraud controls with PricewaterhouseCoopers in September 2005 and received additional in-house training on the Atlas software. The two Audit Specialists who joined in 2005 also attended the Operations Managers training held in August 2005. All auditors received training in using ACL™ software.

27. Following a proactive and preventive approach, DOS facilitated sessions during the training for UNFPA Operations Managers and Representatives organized by the Fund's Learning and Training Branch; provided advice to country offices and headquarters units on their follow-up actions to audits and on audit requirements for NEX projects; and briefed UNFPA Representatives. The division also provided inputs for the drafting of policies and procedures and was regularly consulted whenever systems and procedures for internal controls were reviewed. Furthermore, staff actively participated as members of several inter-agency working groups advancing UNDG initiatives for simplification and harmonization. These working groups created opportunities for inter-agency information sharing as well as for improvements in internal controls.

III. RISK MANAGEMENT IN UNFPA

A. Risk classification

28. The purpose of risk management in UNFPA is to strike an optimal balance between the maximization of the organization's impact (as defined in the UNFPA mission statement) and related risks. Maximizing impact requires that the organization takes risks in being on the leading edge in its field of

expertise, and in working in adverse or unreliable environments. This approach requires that UNFPA accept risk as part of its operations and minimize its potential negative impact involving, for example, loss of reputation or of capacity to serve clients resulting for instance from inadequate or failed internal processes or from external events.

29. For the purpose of the present and subsequent reports, it is important that the classification of risks is structured to enable analyses and to provide comparable results over time. Categorization must be done consistently and should follow a logical pattern. To better fit with its mandate and operations framework, UNFPA has followed the model proposed by the Zurich Strategic Risk Group[2], which is a modification of the Basel Committee on Banking Supervision (BCBS)[3] model.

30. The five categories of risks are:

(a) People: loss events resulting from the actions or inactions of a person who works for UNFPA entities (headquarters, regions, country offices);

(b) Business process: loss events arising from UNFPA execution of business operations;

(c) Relationships: loss events caused by the interaction with clients, regulators, or third parties. For instance, this category would cover the risks related to the execution of country programmes;

(d) Technology: loss events due to piracy, theft, failure, breakdown, or other disruption in technology, data or information. This category also includes technology that fails to meet the intended business needs;

(e) External: loss events caused by people or entities outside UNFPA (the organization cannot control their actions).

31. This classification will be adopted for all risk management activities through a systemic approach including oversight activities, risk mapping, improvement of risk controls, and reporting to the governing bodies.

B. Risk model

32. The purpose of the risk model is (a) to assess the risk profiles of UNFPA entities and therefore to decide on the priorities of the audit missions to be undertaken in the year by the Division for Oversight Services; and (b) to keep track of the Fund's risk universe. The risk model developed for the selection of the field audit locations in 2006 maintains the importance of more frequent audits of the larger (in terms of financial expenditure) and more risky entities. The model also includes considerations of financial management and programme performance to strengthen what appear to be under-performing entities. The quantitative aspects of the model serve as the basis for further analysis and for further discussion with the oversight committee.

33. The risk model used last year was reviewed and improved to include additional indicators of external risk such as governance and NEX audit processes. These indicators provide management with opportunities to more clearly focus the limited oversight resources on those entities that require strengthening. The model will continue to be improved through an iterative process based on the accumulation of a series of data, and a more accurate weighting of variables. The model will also be

[2] Gene Alvarez, "Operational Risk Event Classification", Zurich IC Squared, www.ic2.zurich.com.

[3] Bank for International Settlements, "Basel II: International Convergence of Capital Measurement and Capital Standards: a Revised Framework, November 2005.

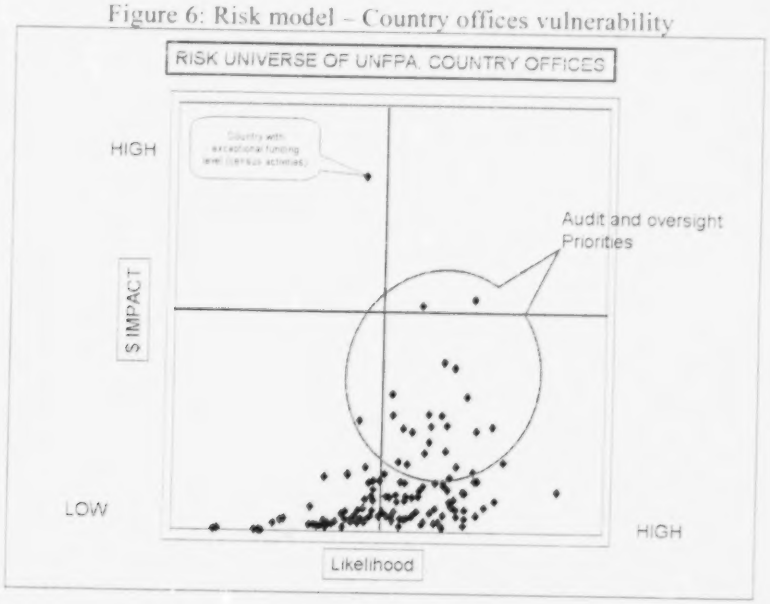
further expanded to incorporate other entities (headquarters divisions and units and regional entities). The list of variables is provided in annex 2.

C. Risk model results

34. The risk model gives two types of results: (a) an entity-specific risk assessment, based on the 14 independent variables listed in annex 2; and (b) a global one, based on the aggregation of variables for each risk category.

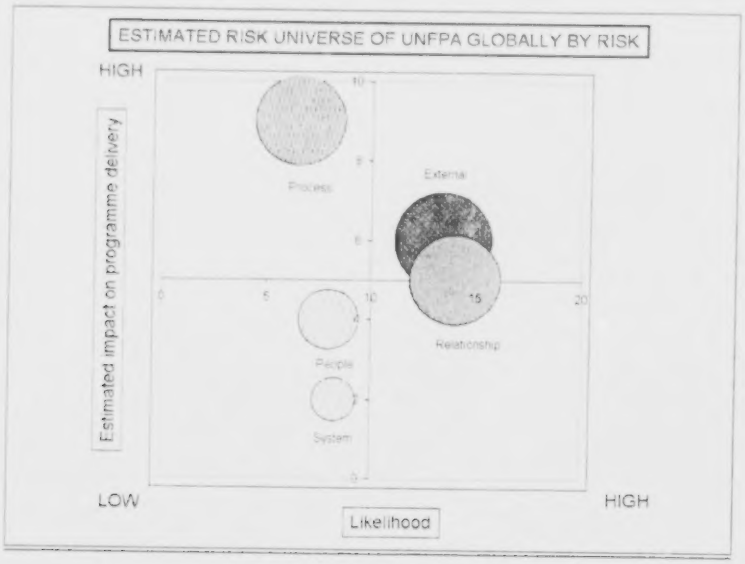
35. Figure 6 shows the risk universe of UNFPA country offices. This tool is updated every year to track changes in the risk universe of UNFPA and to plan audit engagements and optimize the use of resources.

Figure 6: Risk model – Country offices vulnerability



36. The aggregation of variables by categories of risk enables the model to assign each risk with a likelihood (i.e., the probability of occurrence), an impact (the monetary effect), and to compute both to assess vulnerability. The results of this methodology are depicted in figure 7, a matrix showing two dimensions, namely, impact and likelihood.

Figure 7: Risk universe of UNFPA



37. Each circle in figure 7 above represents a category of risk as described in annex 1. The size of each circle is proportional to the "vulnerability", i.e., the sum of all products of the likelihood by estimated dollar impact for each category of risk.

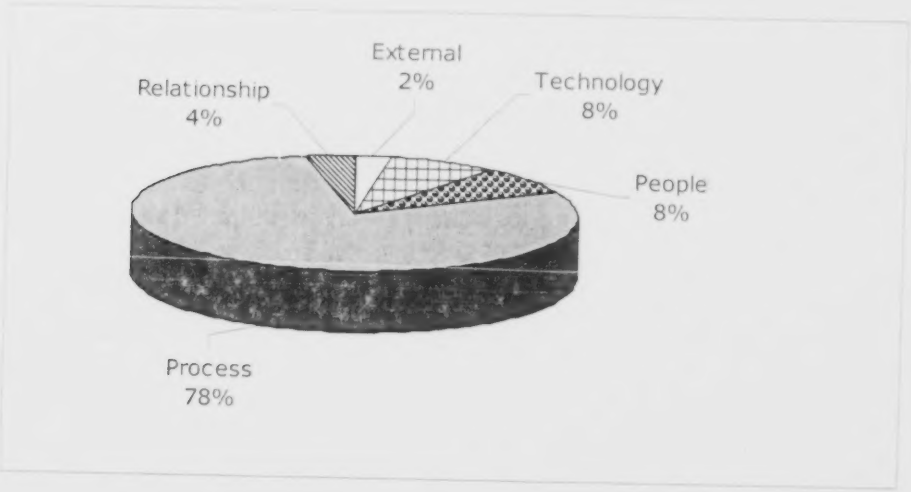
38. Figure 7 shows three circles with high expected values: process, external, and relationship. In order to minimize the residual risk, management should focus on "process" and "relationship" as UNFPA has little leverage on external risks. For both "process" and "relationship", risk minimization could be achieved by better compliance with UNFPA rules, regulations and procedures and through better monitoring of advances made to partners, and more reliable controls in partners' management procedures. This will be further validated by the analysis of data in the section below.

39. As noted in the introduction of the present report, the model will further improve as DOS collects data over the years (standard data collection), and completes the systemic approach it initiated in 2006. It is expected that in approximately two to three years, UNFPA will be able to assess the likelihood of risks with more accuracy.

IV. ANALYSIS AND TRENDS BY RISK CATEGORIES

40. The distribution of 2005 audit observations by categories of risk is depicted in figure 8.

Figure 8: 2005 Audit observations by risk category



A. Process risks

41. Process risks are defined as the risks related to the execution of transactions and the various aspects of running UNFPA business processes, including programmes, products and services. Process risks by area (see figure 9) include the following:

(a) Programme management: risks pertaining to monitoring resource mobilization, partner contributions, project budgets, project expenditure and project advances; project development and approval process; preparing and implementing monitoring and evaluation plans; planning and implementing the NEX audit process by UNFPA, partners and auditors; project closure process; preparation of financial reports by partners;

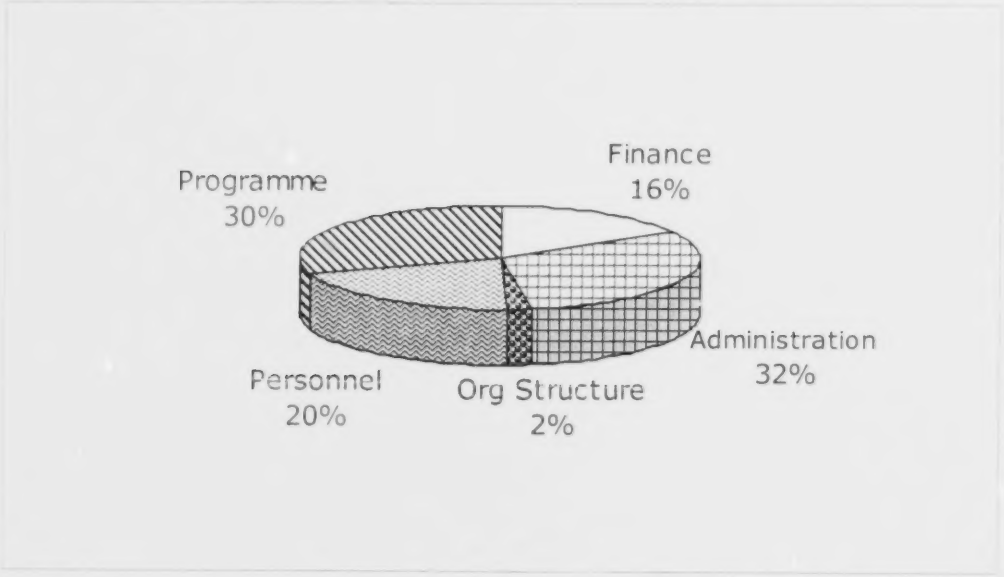
(b) General administration: risks pertaining to procurement procedures including competitive selection and approval; evaluation of suppliers; vendor database maintenance; inventory management; vehicle management; travel management;

(c) Personnel and organizational structure: risks pertaining to contracting process; staff performance evaluation and development; general organization of the office; guidance from headquarters;

(d) Finance: risks pertaining to management of cash advances; disbursement and financial monitoring processes;

(e) Information technology: risks pertaining to Atlas user access rights; back-up and disaster and recovery plans.

Figure 9: Breakdown of causes of process risks



B. Other risks

Technology and systems risks

42. The main areas of technology risks in 2005 are listed below:

Technology risk areas	*Per cent of total (technology risks)*
Computer security and maintenance	48%
Disaster recovery plan and back up of data	35%
Communication systems – email; internet connectivity	9%
IT hardware	5%
Other	3%
Total	**100%**

43. In May 2005, a report evaluating the implementation of PeopleSoft (Atlas) was prepared by external consultants funded by UNDP, UNFPA and UNOPS. The report highlighted improvement in business processes. The Atlas system allows better financial monitoring including cash advances to implementing partners, and facilitates the monitoring of UNFPA assets. However, the report also identifies a number of areas to build on, e.g., the need for additional training for staff, as well as some technical issues.

People risks

44. The main areas of people risks in 2005 are given below:

People risk areas	*Per cent of total (people risks)*
Timely appointment and competitive recruitment process	19%
Staff training	19%
Leave and attendance records	10%
Special service agreement (SSA)/Service contract modalities, competitive selection and assessment	10%
Job descriptions and organizational chart issues	7%
Performance appraisal and development (PAD) appraisals	5%
Other	30%
Total	**100%**

Relationship risks

45. The main areas of relationship risks in 2005 are listed below:

Relationship risk areas	*Per cent of total (relationship risks)*
Compliance with requirements and finalization of project documents and letters of understanding	59%
Financial closure of projects	8%
UNDP common services	6%
Other	27%
Total	**100%**

External environment risks

46. The main areas of external risks in 2005 are listed below:

External risk areas	*Per cent of total (external risks)*
Adjustments and recovery relating to inadequate partner accountability	39%
Filing and registration – e.g., opening bank accounts; signing workplans	29%
Validation of counterpart signatures	14%
Securing and recording assets at risk of theft	14%
Other	4%
Total	**100%**

C. Responding to risks

Programme

47. The revised UNFPA Policies and Procedures Manual provides, inter alia, expanded guidance to country offices on the formulation and monitoring of resource mobilization plans. Country offices are organizing training for implementing partners on UNFPA financial and administrative requirements. Also, during monitoring visits, country office staff review the financial and administrative processes in place for projects to ensure that they meet the requirements for proper internal controls. In addition, DOS reviews the action plans on the implementation of audit recommendations prepared by the implementing partners with the assistance of country offices and provides comments to strengthen internal controls where needed.

48. The Atlas system provides country office managers with additional tools to strengthen their oversight of project budgets and expenditures. The increased emphasis and guidance on monitoring and evaluation in the revised UNFPA Policies and Procedures Manual is expected to reduce the risk and magnitude of weaknesses. The new NEX processes set up by the UNDG Executive Committee agencies are being implemented starting in 2006 and are expected to reduce the risks and potential impact of NEX audit weaknesses on the programme. To address the project closure risks, managers are being reminded of their duties to adhere to project closure procedures and the Atlas system is allowing managers to monitor financial information in a more timely manner. To improve the quality of financial reports prepared by partners, offices are continuously training partners, however the high turnover rates and vacancies in partner staff are hampering efforts in this area.

Human resources and organizational structure

49. The risk management plan envisages the following with regard to human resources and organizational structure:

(a) Country offices commit to revising their organizational charts to reflect the new typology;

(b) The implementation of the performance appraisal and development system to ensure compliance with requirements is ascertained by consistent follow up by focal points from the Division for Human Resources;

(c) Training of country office staff is included in the planning phase of the performance appraisal and development system. The offices commit to preparing a training plan early in the year and monitoring its implementation;

(d) Offices commit to following a competitive recruitment process, preparing performance evaluations for individuals on service contracts and special services agreements and meeting reporting requirements.

Finance

50. The Fund's Financial Rules and Regulations were updated in 2005. UNFPA has also drafted an internal control framework. The document aims at assisting country offices in implementing effective internal controls. It outlines many of the internal controls considered useful in safeguarding the assets of the organization and covers a wide scope of the many components of internal control including planning,

monitoring, communication, segregation of duties, individual authorities and accountabilities. This document will be issued in 2006.

51. Furthermore, the Operations Managers who joined in 2005 received a two-week training at headquarters and are expected to enhance country office managerial capacity, as well as contribute to a more consistent application of controls in the field.

Technology and systems

52. The Atlas Project Executive Committee is fully committed to and engaged in supporting the strategies and activities needed to identify and resolve the current problems and to realize significant improvement in the Atlas system. The issues identified are classified as: (a) low priority issues which require no action at this time; (b) medium or high priority issues (but of low complexity) which UNFPA can take action on – most of these issues have been addressed; and (c) medium or high priority items of high complexity requiring joint action by UNDP and UNFPA. Decisions on how to proceed on these items have been taken and actions initiated. Some actions have been completed but others will require additional time for completion.

V. CONCLUSION

53. The present report is an "interim" document for it attempts to capture the features of the risk universe of UNFPA with data initially formatted for a more traditional analysis of audit issues. Since the report is based on a new approach, an intensive review and analysis was required to aggregate and link different sets of data in a reliable way. The new approach delineated in the present report is the first step of an iterative longitudinal data collection and monitoring process that should enable a more accurate measurement of the likelihood and impact of risks. In two or three years, when it can rely on additional time series, the model will generate a "risk dashboard" for the whole organization. This dashboard will be a tool to better assess areas of vulnerability, to improve internal controls, and eventually to minimize residual risk. Although it seems straightforward at first sight, this new approach has complex implications regarding the way the organization should develop its internal control framework and enhance its culture of accountability.

54. The way to minimize residual risk is to strengthen the internal control framework, that is "the process effected by management designed to provide reasonable assurance regarding the objectives in (a) effectiveness and efficiency of operations, (b) reliability of financial reporting, and (c) compliance with applicable rules and regulations."[4] In 2005, UNFPA started developing an internal control framework and will continue its development on a continuous basis to make it as COSO compliant as possible. By assessing a comprehensive portfolio of risks and by linking it to a risk response (the internal control framework), UNFPA is de facto adopting enterprise risk management, a much larger concept looking at the potential impact of risk on the achievement of the mandate of the organization. The path adopted by the organization is progressive, starting with the assessment of risk, adopting control measures, eventually developing into risk management aiming at an acceptable level of risk appetite, i.e., the amount of risk UNFPA would be willing to accept in pursuit of its mission while remaining on the leading edge of its area of expertise. This progressive approach is a practical and affordable way to implement enterprise risk management in UNFPA, and to induce the required change in the culture of the organization.

[4] The Committee of Sponsoring Organisations of the Treadway Commission (COSO), Enterprise risk management – Integrated framework, September 2004.

55. While the notion of "accountability" has been well integrated in the culture of the organization, its materialization in daily operations leaves room for improvement. The notion of "risk" may offer an interesting opportunity to raise awareness about gaps and to monitor the effects of corrective measures. Risk management is the responsibility of every staff member and should become an explicit part of everyone's job description. However, to enable this change in culture, UNFPA will have to undertake an organization-wide sensitization on risk management very soon. This will require additional resources.

56. Although managers are directly responsible for operations, including risk management, they need the support of an oversight function that works beyond traditional compliance and plays a catalytic role in evaluating effectiveness and efficiency and recommending improvements. Towards that end, the Executive Director requested the UNFPA Division for Oversight Services to take several initiatives. The first step in this process consists of the revision of the audit programme to enable managers and auditors to examine observations, to map risks, to reassess risk tolerance, and to identify proper controls and monitoring. The audit programme has been structured to be pertinent to the classification of risks so that audit observations, including their financial impact can feed into the risk model. The second step in the process is to build greater synergy between audit and evaluation functions within the division to assess efficiency and effectiveness in a larger and more integrated context. The third step will address the issue of the integrity and consistency of data generated and collected during oversight activities for effective benchmarking and monitoring performance in UNFPA entities. To achieve its mandate the organization has to take risks: technical risks, for example, when it experiments with innovative ways to support women, especially in the most destitute communities; financial risks, for example, when it relies on partners for the execution of programmes; and political risks, for example, when it challenges harmful traditional practices. In order to enhance its reliability, efficiency, effectiveness and competitive advantage, UNFPA will seek to minimize the levels of residual risks through a systemic approach. This is the essence of risk management, a complex and promising process, which will require the support not only of all managers in the organization, but also of the members of the Executive Board.

VI. RECOMMENDATION

57. **The Executive Board may wish to take note of the present report (DP/FPA/2006/4) and comment on the reporting format.**

Annex 1: Risk groups and description

Category of risk	Description	Examples of causes
External risk	The risk of loss due to damage to physical property or assets from natural or non-natural causes. This category also includes the risk presented by actions of external parties, such as the perpetration of fraud, or in the case of regulators, the execution of change that would alter UNFPA ability to continue operating in certain countries.	• External misdeeds: External fraud, external money laundering, inadequate partner accountability, corruption, etc. • Disasters: Natural disasters, non-natural disasters, etc. • Litigation/regulation: Regulatory change, legal change, etc.)
People risk	Loss events resulting from the actions or inactions of a person who works for UNFPA. The risk of a loss intentionally or unintentionally caused by an employee – i.e., employee error, employee misdeeds – or involving employees, such as in the area of employment disputes. This risk class covers internal organizational problems and losses.	• Human resource issues: This would cover long vacancies in critical management posts, employee unavailability, hiring/firing, inadequate capacity, etc. • Personal injury – Physical injury: This would include physical harassment, bodily injury, health and safety, etc. • Personal injury – Non-physical injury: Libel/defamation/slander, threats, discrimination/harassment, etc. • Wrongful acts: Fraud, trading misdeeds, infractions of the United Nations standard of conducts. • Employee errors (general transaction errors, incorrect routing of transaction, errors in vouchers, funding authorization and certificate of expenditures, personnel, records, etc.
Process risk	The risks related to the execution and maintenance of transactions, and the various aspects of running UNFPA business processes, including products and services.	• Business process: Lack of proper due diligence, inadequate/problematic account reconciliation, non-recovered advances, incorrect procurement procedures, etc. • Inadequate assessment of business risks: Joint-programming risk, new programme deliveries, operations research activities. • Errors and omissions: Inadequate/problematic security (information technology and staff security), inadequate/problematic quality control, inadequate segregation of duties, misuse of passwords. • Ignored specific liabilities: Employee benefits, employer, directors and officers, etc.

Category of risk	Description	Examples of causes
Relationship risk	Losses arising from the relationship or contact that UNFPA has with its clients, stakeholders, executing or implementing third parties, Governing bodies, donors.	• Funding and support discrimination: Stakeholders and partners discrimination, etc. • Negligence: Gross negligence, general negligence, inappropriate behaviour with counterparts, inadequate political statements or choices, etc. • Specific omissions: Failure to pay proper fees, failure to file proper report, etc. • Violations of legal and contractual obligations: Significant deviations from the country programme document, country programme action plan, and annual work plan in programme strategy and implementation, inadequate reporting to donors, breach of confidentiality, etc.
Technology and systems risk	The risk of loss caused by a piracy, theft, failure, breakdown or other disruption in technology, data or information; also includes technology that fails to meet business needs.	• General technology problems: Operational error – technology related, unauthorized use/misuse of technology, etc. • Hardware: Equipment failure, inadequate/unavailable hardware, etc. • Security: Hacking, firewall failure, external disruption, lack of backup • Software: Use of unlicensed software, computer virus, programming bug, etc. • Systems: System failures, system maintenance, telecommunications, etc.

Annex 2: Risk model – List of variables

Category of risk	Variables
External risk	1. NEX accountability: Per cent of NEX expenditure audited and ratings on NEX audit reports 2. World Bank governance rating
People risk	3. Vacancy in representative, deputy representative or country director
Process risk	4. Financial performance other resources and regular resources 5. Local expenditure dynamics (relation to patterns of disbursements) 6. Monitoring and evaluation activities investment in the two previous years 7. Previous audit rating 8. Programme cycle evaluation, countries starting new country programmes are higher risk 9. Requisition dynamics and purchase orders dynamics (time pattern) 10. Time since last audit 11. Vacancy in representative, deputy representative or country director
Relationship risk	12. Operating fund account management 13. Resource mobilization performance
Technology and systems risk	14. Quality of Atlas input

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